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ABSTRACT

Voluntary support has been a major factor in the financing of American higher education since colonial times. Yet several recent proposals intended as tax reform measures threaten to reduce voluntary donations at a time when the nation's postsecondary institutions are in the throes of financial distress. The income tax proposals that would have an adverse impact on voluntary giving include: (1) legislation proposing that gifts of appreciated property be taxed on all of their appreciation or, in the alternative, that the allowable deduction be limited to the cost basis of the property; (2) charitable contributions to the extent attributable to appreciated property be included within the concept of tax preference; (3) the Minimum Taxable Income Proposal (MTI), which would compel high income taxpayers to wait until the end of the taxable year before calculating their tax status. This would affect the timing and leadership of many capital efforts. Estate and gift tax proposals to higher education would also be affected. Available data indicated that the charitable deduction is an effective way of raising funds for higher education. In the absence of contrary evidence, it would seem highly inappropriate to repeal incentives to give at a time when colleges and universities are struggling to balance their budgets. (Author/PG)

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TAX REFORM 1975: ISSUES FACING HIGHER EDUCATION

by

Sheldon Elliot Steinbach

(As a service to Council members, this background paper has been prepared by the Office of Governmental Relations to aid in understanding one of the major issues affecting higher education to be dealt with by the 94th Congress. Further legislative developments will be reported on a timely basis in Higher Education and National Affairs.)

This spring Congress will once again consider tax reform legislation. The equity of the tax system will come under scrutiny against a background of growing citizen interest in reform and particularly in the plugging of so-called tax loopholes which aid a few wealthy individuals. In this atmosphere, the House Ways and Means Committee will review several proposals which could have a dramatic impact on voluntary support of colleges and universities.

Voluntary support has been a major factor in the financing of American higher education since colonial times. For example, according to U.S. Office of Education estimates, charitable giving provided a critical 7 percent of the operating budgets of the nation's colleges and universities in the 1972-73 academic year. Those who favor tax deductions for gifts to philanthropic organizations (including postsecondary institutions) maintain that voluntary giving to socially useful causes is part of the American tradition in that an individual unselfishly parts with money or property so that a public service may prosper. Regardless of an individual's tax bracket, the voluntary act of making a charitable contribution leaves the taxpayer with a lesser net worth. The Tax Reform Act of 1969 eliminated abuse of the charitable deduction and no individual profits by making a charitable gift.

Yet several recent proposals intended as tax reform measures threaten to reduce voluntary donations at a time when the nation's postsecondary institutions are in the throes of financial distress. Their advocates maintain that the charitable deduction provides only a slight incentive to voluntary giving, that it favors the rich (who can better afford to make gifts than those in the lower income brackets), and that all tax deductions and credits erode the tax base.

HE 006 254

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Instead of filling the tax code with backdoor subsidies for various groups, some argue, Congress should remove all deductions and credits and should appropriate funds to meet the nation's legitimate needs directly.

Higher education is substantially dependent on the large gift. A recent study* indicated that about 5 percent of all transactions--those over $5,000--produced 75 percent of all voluntary support. This same pattern holds true for gifts from individual donors (alumni and nonalumni), which in 1971 constituted 51 percent of all voluntary support. Moreover about 60 percent of individual gifts including bequests exceeding $5,000 were received in the form of securities, real estate and other property, which underlines the importance of tax treatment of these gifts.

Income Tax Proposals That Would Have An Adverse Impact On Voluntary Giving

1. Of particular concern to college and university officials is the proposals that gifts of appreciated property be taxed on all of their appreciation or, in the alternative, that the allowable deduction be limited to the cost basis of the property. As a result of the Tax Reform Act of 1969, appreciated capital assets given to a private foundation are not deductible at their full fair market value. A charitable deduction is reduced by one-half of the capital gain the individual would have if he had sold the property at market value. Legislation proposing similar treatment for gifts of appreciated property given to any public charity (including higher education institutions) may be introduced. If adopted, such a proposal may reduce private support for higher education out of all proportion to revenue realized by the Treasury.

2. Congress found in the hearings preceding the Tax Reform Act of 1969 that, because of the preferences set within the tax code, some individuals received substantial income without paying any tax whatsoever. To rectify this abuse, the minimum tax on tax preferences was established. Legislation proposed last year would have reduced the $30,000 exemption contained in the present law to $12,000 and would have increased the minimum tax from 10 percent to 30 percent on the so-called preference income. Of primary significance to colleges and universities is that fact that charitable contributions to the extent attributable to appreciated property would be included within the concept of tax preference.

3. In early 1973, the Treasury Department unveiled its minimum taxable income proposal (MTI) which sought to establish a new alternate tax computation. Under this proposed new system, a taxpayer would pay his regular tax or this alternate tax, whichever was higher. The new tax would limit an individual's total itemized deduction, including charitable contributions, to approximately one-half of his adjusted gross income and impose a tax on the remaining "excess" deductions. This provision would compel high income taxpayers to wait until the end of the taxable year in order to calculate his tax status. This would affect the timing and leadership of many capital efforts. In addition, the MTI proposal virtually eliminated the carry-over provisions of the current tax law for gifts which exceed an individual's annual limitation.

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*Julian H. Levi and Sheldon Elliot Steinbach, Patterns of Giving to Higher Education II (D.C.: American Council on Education, 1973).

4. Of most recent vintage is a compromise proposal forged between the Treasury's MIT and the Ways and Means Committee's attempt to strengthen the bite of the existing minimum tax. Out of the merger appeared an entirely new proposal called an "economic income tax." This proposal provided no deduction for unrealized appreciation on gifts to charity. A donor would be limited to a deduction for his cash gifts to charity plus his cost basis in any property given. The taxpayer would then pay the higher of either his tax calculated in the regular manner or his separately computed tax on one-half the regular rate schedule on items denoted as economic income. This proposal, if enacted, could have a substantial chilling effect on gifts of appreciated property by cutting their full deductibility.

Estate and Gift Tax Proposals

Bequests have become an increasingly important means of support of American colleges and universities. The Council for Financial Aid to Education reports in its 1972-73 "Survey of Voluntary Support" that the institutions of higher education received $255.9 million, representing 14.6 percent of total support received and approximately 29 percent of the total share of support by individual donors.

1. It has been proposed that the estate and gift tax structures be integrated. Under the present system, estates are taxed without regard to that portion of the wealth which is transferred by lifetime gifts. If the estate and gift tax systems are joined, wealth transferred at death would be taxed at a higher rate because the property devised by bequest would be "stacked" on top of lifetime gifts to determine the appropriate tax rate. The additional tax burden imposed by such a provision would diminish the amount left in the residuary estate, thereby lessening the amount of money received by colleges and universities and decreasing the incentive of donors to use the lower gift tax rates to make gifts currently.

2. Another proposal almost certain to be considered by Congress would limit the amount of an estate which could be given tax free to a public charity. Specifically, the charitable deduction would be limited to 50 percent of the gross estate. One can only speculate about the impact of this proposed drop in bequests received by colleges and universities, with the likelihood that substantial donors may well limit their testamentary gifts to those portions of their estates that are deductible.

3. Under existing law when a taxpayer holds an appreciated asset until his death, the appreciation is not subject to income tax, while at the same time, the legatee is allowed a step-up in basis, so that on a subsequent sale, this portion of the gain is not taxable. The Treasury Department has stated that the present system of not taxing appreciation of assets transferred at death "is grossly inequitable and substantially impairs the progressivity of the tax structure." It has been proposed to tax the appreciation of assets transferred at death as if the assets had been sold on the day of the decedent's death. A former Treasury Department proposal which would have excluded capital gains treatment for assets transferred at death to a public charity has not resurfaced. Unless the proposed provision for public charities is reinstituted,

colleges and universities will suffer a substantial financial setback. At the very least, bequests will be reduced by the amount of tax, and it is even possible that the imposition of the tax could, in some instances, deter the donor from making the bequest at all.

Conclusion

Available data thus indicate that the charitable deduction is an effective way of raising funds for higher education. In the absence of contrary evidence, it would seem highly inappropriate to repeal incentives to giving at a time when colleges and universities are struggling to balance their budgets. The gain in tax revenue in many instances would be slight compared with the possibility of serious disruption of the financial stability of some post-secondary institutions.

With the great number of new members, the expansion of the Ways and Means Committee from 25 to 37, and the appointment of a new chairman, it is particularly important that the case for voluntary support of higher education be effectively communicated. Factual data on a national scale are being collected by the American Council on Education so that higher education will be able to marshall the strongest case as to the impact of proposed changes in the Internal Revenue Code. In the meanwhile, college and university spokesmen may wish to take appropriate opportunities to communicate with their Congressional representatives about the importance of voluntary support to their own institutions.